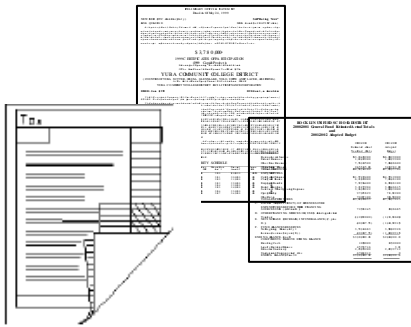


California Association of School Business Officials

Terms, Concepts and Processes in Debt Financing



Presentation arranged by
California Debt and Investment
Advisory Commission

April 22, 2003

Introductions

- **Introductions, in order of speaking**
 - **Terri Ryland, Government Financial Strategies, inc.**
 - **John Larner, CBO, Anaheim USD**
 - **Rodrick Carter, RBC Dain Rauscher**
 - **John Hartenstein, Orrick, Herrington & Sutcliffe**




Today's Agenda

- **Common terms in the debt issuance process**
- **Types of debt issuance**
- **Building and managing the finance team**
- **Structuring the financing**
- **Credit enhancement**
- **Credit ratings**
- **Disclosure and the legal documents**



What is Debt?

- ***n.* something that is owed, or that one is bound to pay to or perform for another. (Random House Webster's College Dictionary, April 2000)**
 - Or simply put, a promise to do something in the future in return for something today
 - **Debt happens (promises made and accepted) when there is good faith and trust.**
-  *“I will gladly pay you Tuesday for a hamburger today”.*
—*J. Wellington Wimpy*

Return on Your Investment

- All school business officials should have a comfort level with the concepts, the terminology, the math, and how to handle the “players”.
 - Every deal should be a good deal for kids!
- Hopefully, everyone here will feel more knowledgeable and confident with the topic of debt by the end of the day. You may even have reason to question past practices. That’s okay! We’re all here to learn, and to take back to our districts improved practices. And, in some cases, debt you’ve already issued can be administered better or restructured.

Constitutional Debt Limit

■ Limitation on issuing long-term debt:

– California Constitution, Article 16, Section 18a:

» *No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public entity voting at an election to be held for that purpose [...]*

– In other words, the voters must have a say!

– TRANs are not debt because they are short-term.

– Lease-purchases are not debt because they are contingent.

■ Obviously the 2/3 majority can now be 55% under the Prop 39 election method, which we will discuss later.

Why Are We Here Talking About Debt?

- Debt is one of the top factors in fiscally troubled districts.
- School districts of all sizes and situations issue debt, and often with good reason.
 - The CDE estimates that \$4 B is needed annually over the next 5 years for new construction and modernization.
 - In 2002, \$6.8 billion in long-term debt was issued for California schools, in 329 separate issues, (and that is just what is reported to the California Debt and Investment Advisory Commission).
 - Debt transactions are often complex.
 - Debt usually has long-term fiscal impacts which may not be well understood at the inception.
 - There is a lot of bad information out there, which is resulting in poor decisions.
- *Our goal today is to increase your finance skills so your district can borrow appropriately and you can lead with confidence.*

Financing - Principles and Jargon

ad valorem

Revenue Bonds

COP

Limited Tax Bonds

Mira-Hart-Murrietta

AV

Prop 1A

demographics

POS

Arbitrage

Stirling Fees

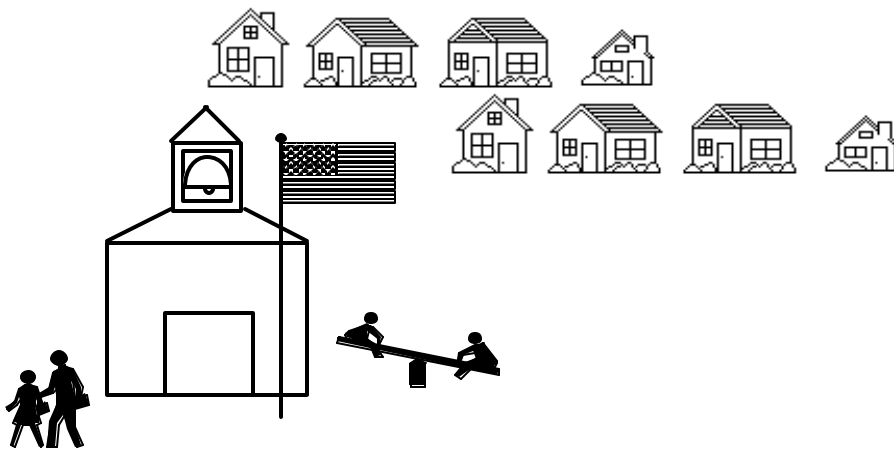
Rebate

TIC

SB 50 Fees

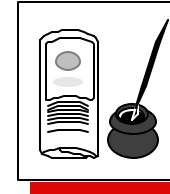
Need Drives Everything

- The Board and the administration are busy running an institution - the School District
- Every borrowing should be driven by:
 - A financial need for cash now, and
 - A feasible repayment plan

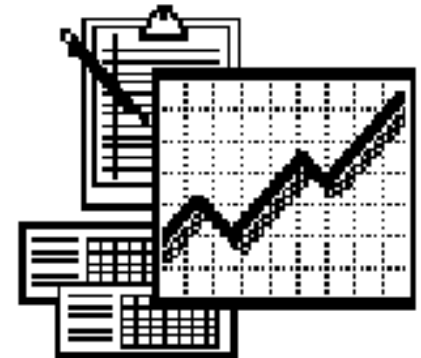


Two Reasons To Borrow Money

■ **Cash Flow**



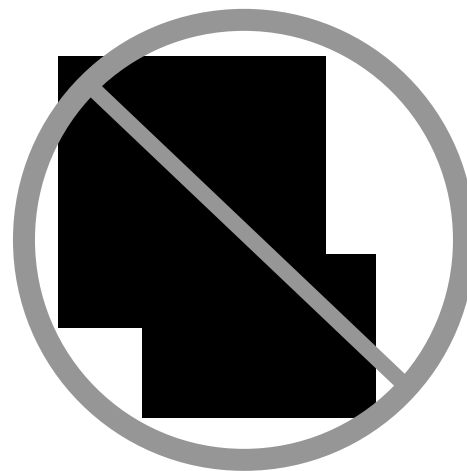
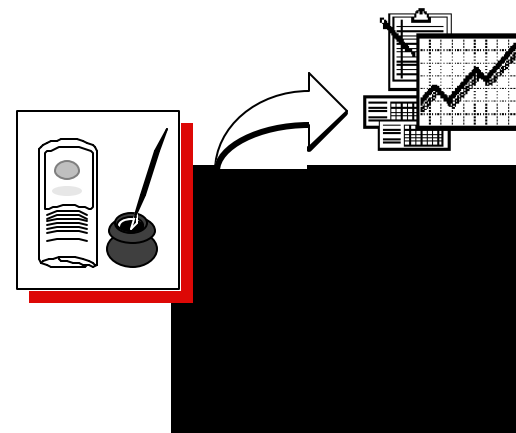
■ **Economic Advantage**



Borrowing as a Cash Flow Strategy

- Borrowing for school facilities is similar to borrowing for a home. We borrow because we don't have the money today, but we will have the money over time, and we don't want to or can't wait.

- It can be appropriate to borrow for capital items with asset value.
- It is not appropriate to borrow for operating items.
 - » Don't put the groceries on the Visa card.



Borrowing Money is Buying Money

- Money is the ultimate commodity
 - It can be exchanged for any commodity
- The only difference between the money of one lender versus another is price
 - » Up-front (points or costs of issuance)
 - » Over time (interest)



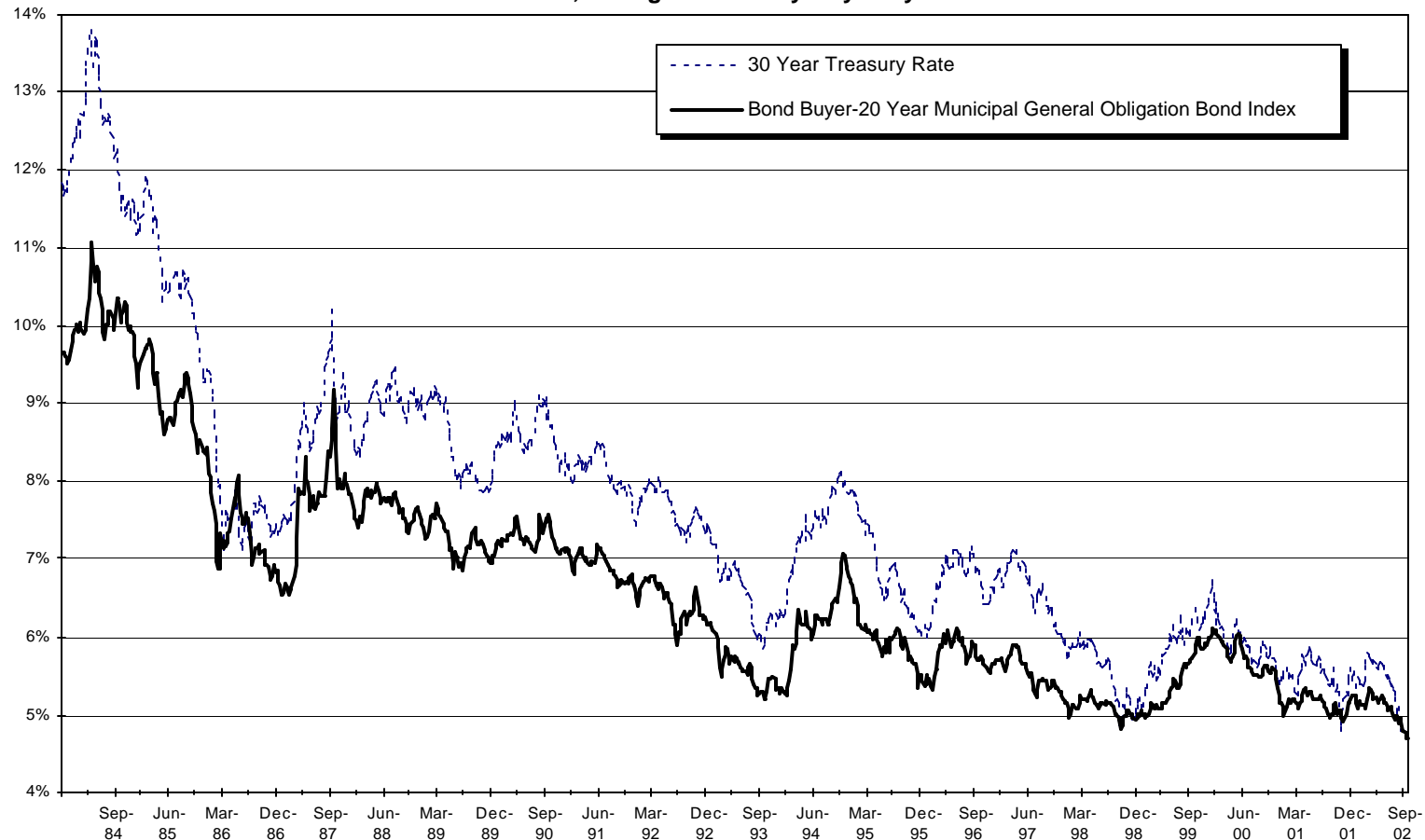
Borrowed Money Must Be Repaid



**"I'd like to borrow just enough
to get myself out of debt."**

Borrowing as an Economic Strategy

The Interest Rate On Tax-Exempt Municipal Bonds Is Almost Always Lower Than The Rate On Taxable Treasuries, Though Not Always By Very Much.



The 20-Bond Index consists of 20 general obligation bonds that mature in 20 years and is compiled every Thursday. The average rating of the 20 bonds is roughly equivalent to Moody's Investors Service's Aa3 rating and Standard & Poor's Rating Service AA-minus. The 30 Year Treasury bond yield is the quote at 3:15 pm Eastern time by Liberty Securities Co. on Thomson Municipal News.

There Are Only Three Sources of Money

- Money in the Cookie Jar
- Someone Else's Money
- Money to Come in the Future



Also known as:

- cash on hand
- gifts/grants/new taxes
- Borrowing



Borrowing works only when there's "Money to Come in the Future" - not because we don't have money now

Financing Options for Schools in California

■ State

- State School Facility Program
- Library Bond Act
- Joint-Use Programs

■ New Development

- Developer Fees

■ Existing Community

- Benefit Assessments
- Mello-Roos Special Taxes
- Parcel Taxes
- General Obligation Bonds

■ Existing Funds

- Lease Purchase, Certificates of Participation



3 Ways for Schools to Borrow Money

■ Notes

- Short Term Borrowing in “Anticipation” of Revenue**
- Repaid from Specified Revenue**
- Examples: Tax and Revenue Anticipation Notes, Grant Anticipation Notes**

■ Bonds

- Require Voter Approval**
- Repaid from Taxes**
- Examples: General Obligation Bonds, Mello-Roos Bonds**

■ Lease-Purchase Agreements

- Repaid from Annual Appropriation**
- Examples: Vendor Leases, Certificates of Participation**

Types of School Debt

	VOTER APPROVED	SCHOOL BOARD AUTHORIZED
	Repaid via tax on property owners	Repaid from District funds
SHORT-TERM	PARCEL TAX	TRANS (or GAN OR RAN)
		LEASES
LONG-TERM	GENERAL OBLIGATION BONDS	LEASES
	MELLO-ROOS BONDS	CERTIFICATES OF PARTICIPATION (COPs)

Tax and Revenue Anticipation Notes

- **Tax and Revenue Anticipation Notes (TRANs)**
 - **Short-term debt instruments used to finance cash shortfalls in anticipation of receiving taxes and other revenues (Government Code Section 53850 et. seq)**
 - » **There are often “dips” in the monthly cash-flow.**
 - **Especially in December and April when property tax revenue is disbursed (typical “dry periods”)**
 - **Sometimes provide districts with additional income through arbitrage (not the reason to issue though)**
- **Under California law, TRANs are the only method allowed for working capital (operating funds) borrowings**
- **Stand alone, joint marketing effort, and TRANs pools**

Community Funding

- **Mello-Roos Special Taxes**

- Introduced in 1982

- **Parcel Taxes**

- Authorized in 1978 by Proposition 13 as a “special tax”
- Further defined in the Government Code

- **General Obligation Bonds**

- Restored in 1986 by Constitutional Amendment

☞ *All require a vote of some kind.*

Tax Elections Approve Taxes

- When the voters approve a special tax measure (such as Mello-Roos or parcel taxes), they are committing to pay a specified tax annually which is collected on the regular property tax bill. The District may capitalize this revenue source and repay it over time or may use the revenue for “pay as you go” projects.



Benefit Assessments

- Purpose is to fund public purpose capital improvements which beneficially affect a well defined and limited area
- Amount of assessment must be proportional to the benefit received and must not exceed the cost of the improvement
- Subject land owner(s) must be given an opportunity for a hearing
- Proposition 218, in November of 1996, imposed a balloting requirement.



School Facilities Improvement District

- A SFID may consist of a portion of the territory within a school district or community college district.
 - The governing board of the school district shall define the boundaries of the SFID to include any portion of territory within the District, except that the boundaries may not include all or a portion of the territory of a Community Facilities District, that has as one of its purposes the construction of school facilities .
- A SFID may issue general obligation bonds to benefit the land within the SFID.

Bond Elections Approve Bonds

- When the voters approve a general obligation bond measure, they are authorizing the School District to issue a specified amount of bonds, and agreeing to repay those bonds through whatever property tax levies are necessary. Therefore, the tax rates are a function of the annual debt service (which is based on the amount of bonds sold) and the tax base.

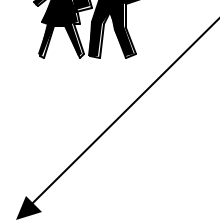
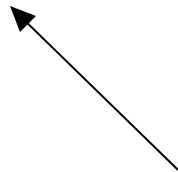
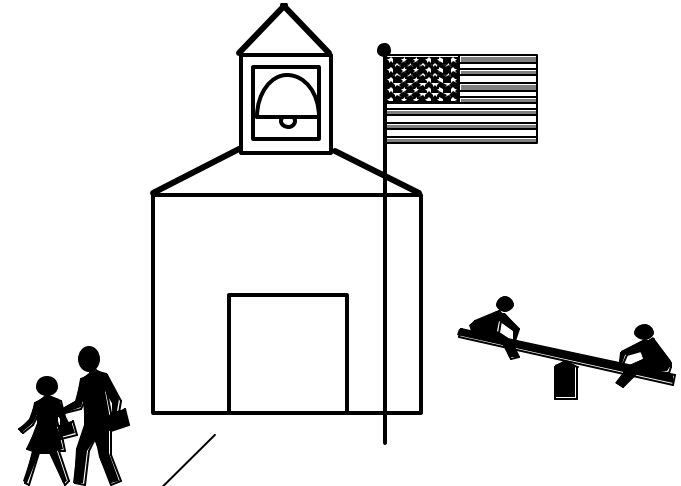
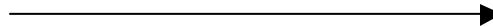


Bond & Tax Methodologies

- **General Obligation Bonds**
 - General Taxing Authority
 - *Bonds determine the tax.*
- **Mello-Roos and Parcel Special Tax Bonds**
 - Limited Taxing Authority
 - *Tax determines the bonds.*

G.O. Bonds

A bond is a loan - from investors that is used by the school district to build facilities for the community which will repay the loan.



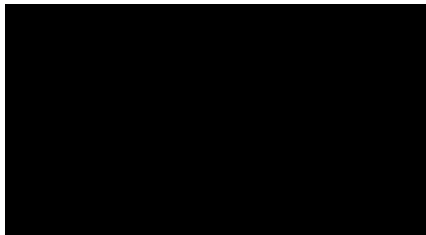
Why Use Bonds?

- **It distributes payments for a project over its useful life.**
 - **Similar to taking out a long-term mortgage to finance a home.**
 - » **Also, like a mortgage, the Federal Government subsidizes the interest on municipal financing.**
 - **Unlike a mortgage, bonds are paid back over the many generations that will enjoy the facility.**
- **The interest paid on bonds will be based on the lowest interest rates available.**
 - **The Federal Government of the United States can borrow at exceptionally low rates**
 - **Bondholders are willing to accept even lower interest rates for local government bond issues because these bonds are exempt from Federal and State income tax.**

Why Use *General Obligation* Bonds?

■ Tax Base Diversity

- General obligation bonds spread the debt burden over many types of property. Virtually all property-owners pay property taxes, and thus it is not just residential property owners who are bearing the cost of making the community a better place to live.



Traditional 2/3 Voter Approval G.O. Bonds

- **Unlimited Taxing Authority**
- ***Ad Valorem* Taxation**
- **Legal Bonding Authority Limited**
- **Expenditures Limited to Improvements to Real Property**
- **Traditional Method of School Construction Financing (1910)**
- **County is Responsible for Ongoing Administration**
- **No Political Discretion**
- **2/3 Voter Approval Required**
- **An election may be held on any Tuesday that is not the day before, day after or day of a state holiday.**

Additional Requirements of 55% Method

■ Additional Requirements

– Oversight Committee

» Additional Audit Procedures

– Standardized Ballot and Taxes

» Certain new statements required in ballot language

» Restricts election dates to regularly scheduled district-wide election dates

» When issuing bonds, a union district must verify that the projected annual tax levies will not exceed \$30 per \$100,000 of assessed value (\$60 per \$100,000 of assessed value for a unified school district).

■ Expenditures may include Furniture and Equipment

■ Expenditures may not include administrators salaries

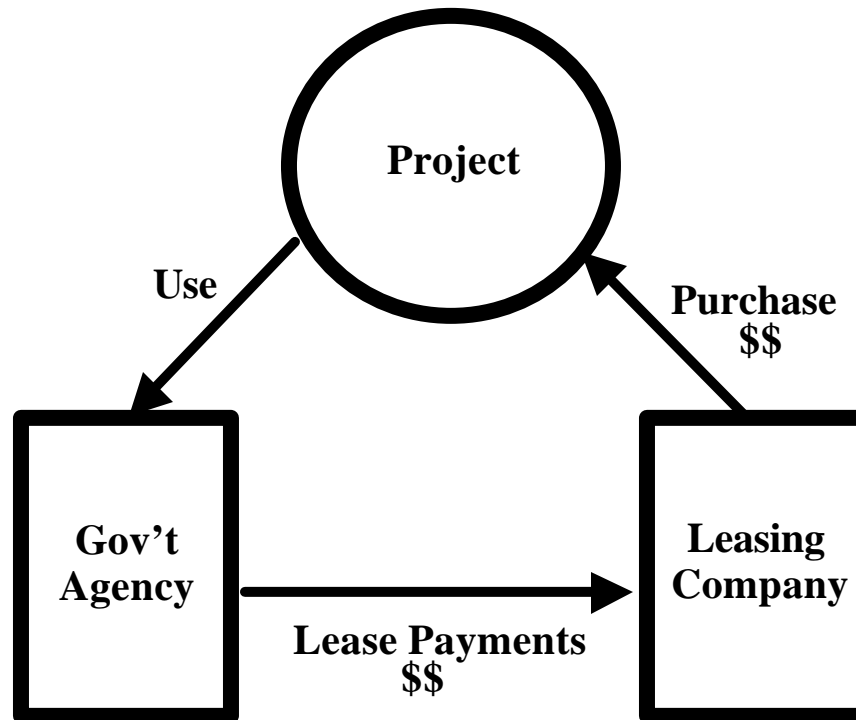
Using Existing Funds: Lease-Purchase

- Lease-purchase financing is a credit purchase.
- Lease-purchase financing is essentially a loan.
 - Get a lease payment schedule
- Lease-purchase financing can be used to purchase equipment such as furniture, buses & computers.
- Lease-purchase financing can be used to fund construction and real property acquisition.

Why Is Lease-Purchasing Not “Debt”?

- **The District does not need to go to the voters to lease-finance because a lease purchase is not considered “debt” under Article 16, section 18a of the California Constitution.**
- **Why?**
 - **The leases are structured with one of the following provisions:**
 - » **Abatement - the school district’s obligation to make payments is abated when it does not have full-use of the leased facility (also called “Offner-Dean leases after the 2 key court cases that distinguish leases from debt).**
 - » **Annual Appropriation - the school district has the opportunity every year not to appropriate lease payments for the following year.**
- **Leases are still counted as debt on the district’s balance sheet.**
- **After Richmond USD’s bankruptcy, school districts are not allowed to use lease-financing for operating expenses (not that they ever should have!)**

Standard Lease-Purchase Structure



- Payments represent full amortization of purchase price at a set interest rate.
- Title transfers at the end of lease.

Certificates of Participation

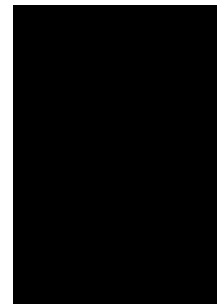
- Certificates of Participation allow debt to be sold in the conventional municipal bond market.
- Certificates of Participation are a method of packaging a lease-purchase transaction to look like a bond for sale to traditional bond investors.

“

Certificates of Participation evidencing . . .

”

fractional . . . interests in rental payments.



Reasons for Certificates of Participation

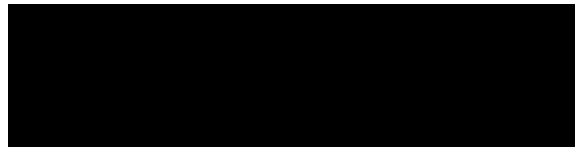
- Access to conventional bond market can provide a lower cost of borrowing (lower interest rate).
- Conventional bond market accepts longer term borrowings than leasing companies (lower payments).
- Conventional bond market accepts larger borrowings than leasing companies.

Bond Sale Methods

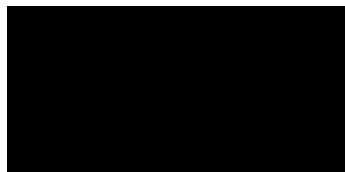
■ **Competitive (auction)**



■ **Negotiated (sale to pre-selected underwriter)**



■ **Private Placement (sale to private party)**

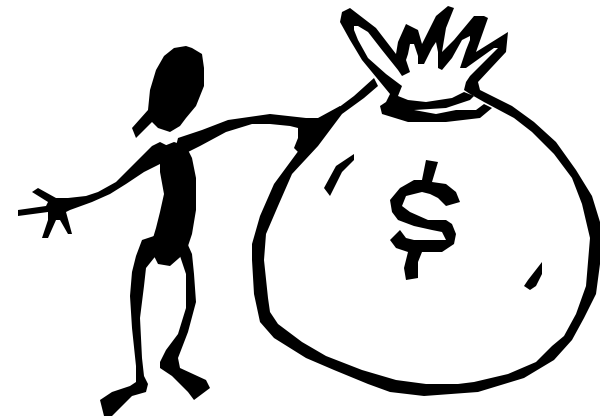


Competitive versus Negotiated

- **Competitive** - public auction where underwriters submit bids and the lowest-cost bidder is awarded the purchase. Bids are submitted by “trading desk.”
- **Negotiated** - an underwriter is selected prior to the sale and assists the issuer and financial advisor in the structuring and documentation, then purchases the bonds at a negotiated price (a function of underwriter’s discount and interest rate.) Communication is through an investment banker, not a trader.
- **The Government Finance Officers Association recommends that “competitive sales should be used to market debt whenever feasible.”**
 - We would add, as long as there are at least three bids, therefore, truly competitive.
 - Research the level of interest among traders (not investment bankers) ahead of time.

Costs of Issuance

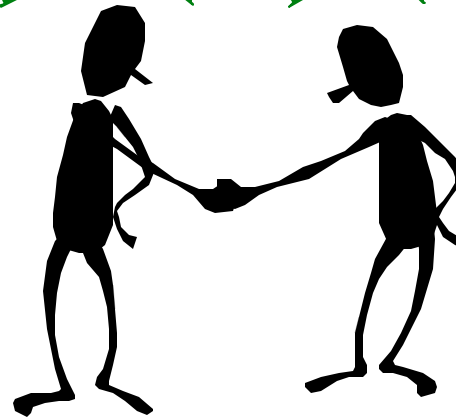
- **Costs of Issuance (COI) include everything it costs to complete a financing**
 - **Financial Advisor**
 - **Bond Counsel**
 - **Rating Agency**
 - **Underwriter**
 - **Trustee**
 - **Bond Insurance**
 - **Other (printing, publication, election costs, etc.)**



☐ *COI = principal - deposit to project fund + any costs billed later*

Parties to a Securities Transaction

Borrower Lender



Public agency/
tax payers

Borrower



Financial Advisor

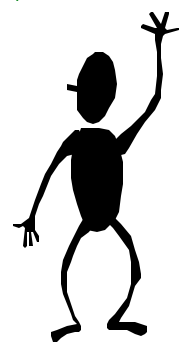
Bond Counsel

Rating Agency

Underwriter

Trustee

Lender



Typical Cast of Characters

- **Financial Advisor**

- Advises the borrower on the financing plan.

- **Bond Counsel**

- Gives a legal opinion on the tax-exempt status of the bonds

- **Rating Agency**

- Provides a rating based on credit quality

- **Underwriter**

- Brokers securities and money

- **Trustee**

- Handles the paperwork on behalf of investors

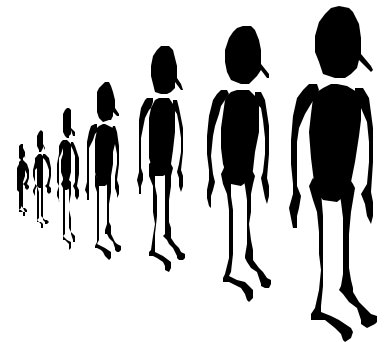
- **Lender/Investor**

- Widows and orphans

- **Taxpayers!**

- ☐ *Most, if not all, of these players have a vested interest in there being a borrowing.*

- *Some of these interests are in opposition to the District's.*



Assembling the Team

- **Begin with the internal team -**
 - **Superintendent**
 - **Business staff**
 - » **CBO**
 - » **Finance, Budget**
 - **Facilities leadership, if applicable**
- **Know their strengths and ideas, and where supplementary help is needed**
- **Determine where the supplementary help should come from**
 - **Consultant**
 - **Temporary employee**
 - **FCMAT**
 - **County Office**
 - **Parents and local businesses**
 - **Etc.**

Plan Ahead

- **Start with the end in mind**
- **Several teams and committees will be contemplated:**
 - **Facilities or Finance Advisory Committee**
 - » **Local school parents**
 - » **Local businesses**
 - **Facilities Master Plan Committee**
 - » **In-house staff**
 - » **Consultants (financial, architects, planners)**
 - **After bond measure passes**
 - » **Oversight committee**
- **Construct and modernize “world class facilities for world class kids”**

What to Look for in a Team Member

- **Financial Advisor - ability to be your staff (time, expertise, do the math, write board reports) Works FOR the District**
- **Bond Counsel -**
 - Prepare legal documents correctly and promptly
 - Provide unqualified legal opinion
 - Consultative, advisory in nature
- **Underwriter and Broker/Dealers -**
 - Absorbing risk
 - Price
- **Ancillary team members:**
 - **Rating Agency/Insurers -**
 - » Only three rating agencies
 - » All about marketing
 - **Trustee and Paying Agent -**
 - » Minimal cost
 - » Use low bidder or defer to what the County wants
- **Lender/Investor -**
 - Lowest cost possible
- ☐ *Identify the needs of the District then put together the team that fits the culture of the District.*

Managing the Team

- **You must know the scope of work to expect - or won't be able to measure success**
 - Write board reports
 - Attend board meetings
 - Supply analysis
 - Take direction
 - Provide appraisals, official statements
- **Concentrate on tasks that make a difference to the organization**
- **Make priorities understood**
- **Build on your own strengths**
- **Take responsibility for information and work relationships**
 - Reporting out from meetings
 - Keeping the Board in the loop
 - Accounting issues and assurances to the taxpayers
- **Place people where their strengths can produce the best results**

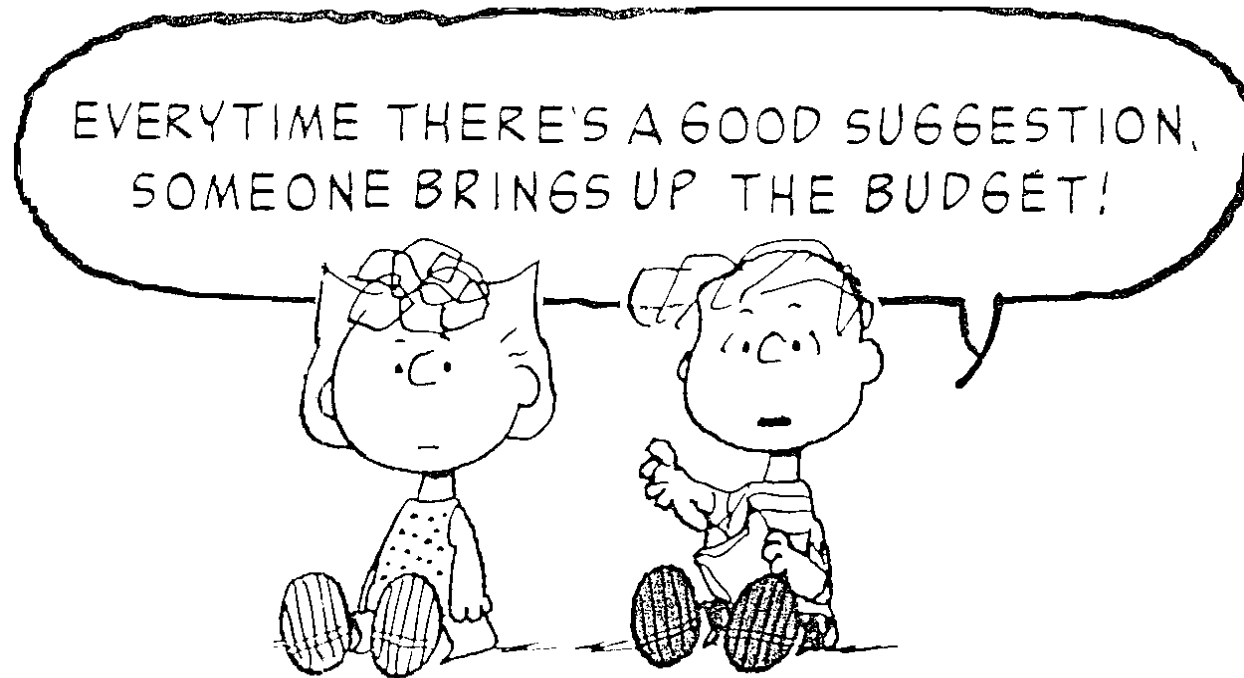
The Board as Trustee

- The Board must decide how much of the budget to spend on capital and debt payments
- The Board should not engage in a deal they don't understand
- The Board should not let themselves get backed into a corner
 - Don't be sold a bill of goods

☞ *Finance is nothing more than algebra*

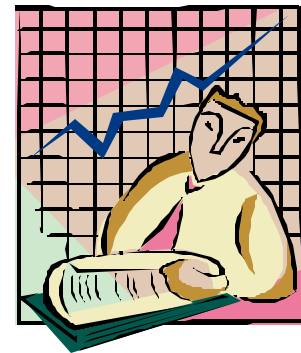


It Always Comes Back to the Budget



Things to Keep in Mind When Borrowing

- **Need a transaction that reflects the financial plan**
 - Want community involvement?
 - » General obligation bond
 - » Mello-Roos bond
 - » Landscaping and Lighting Act
- **Need an approach which assures the lowest costs**
 - Work with bond counsel - want all costs of issuance to be as low as possible
- **Debt is debt**
 - Credit card
 - Mortgage
 - Loan
- **Borrowing is a Means to an End**
 - Implement the borrowing in a style consistent with the district's overall approach
 - Design the borrowing to meet the district's goals

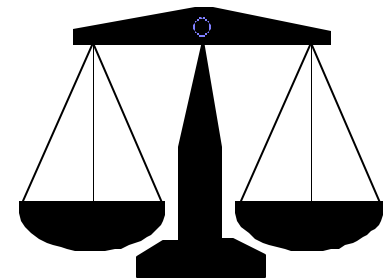


Implement the Decisions Facing the Team

- **Given the variety of options that districts have in financing facilities, how to decide which is appropriate?**
 - **Lenders will loan you money right into bankruptcy**
- **Key Considerations**
 - **Type of Project (item to be financed)**
 - **Repayment Source**
 - **Term of Financing**
 - **Structure of Financing**
 - » **Bonds, Notes, Lease-Purchase**
- **The public agency is the boss**
 - **versus -**
- **handing the project over to the consultants to manage and decide**

Financing Plan to Implementation

- **Financial Advisor should focus on the details necessary to implement the District's financial plan.**
 - **Hence, the Financial Advisor should understand the District and its financial plan and make recommendations that fit.**
- **With a good team (internal and external players) the financial plan will be implemented with integrity and efficiency**
- **The District will want to be assured that it**
 - **Structures the financing properly and**
 - **receives appropriate legal advice and a solid legal opinion....**



Discussion of Debt Structure and Credit Ratings/Credit Enhancement



RBC
Dain Rauscher

Structuring

- **Revenues/Source of Repayment**
- **Tax Thresholds**
- **Current Interest Bonds (CIBs)**
- **Capital Appreciation Bonds (CABs)**

Credit Ratings

- **Finances**
- **Economy**
- **Debt**
- **Management**

Credit Enhancement

➤ Letter of Credit

- Variable Rate

- Credit Quality Considerations

➤ Bond Insurer

- Ambac Financial Assurance Corporation (Ambac)

- Financial Guaranty Insurance Company (FGIC)

- Financial Security Assurance (FSA)

- MBIA Insurance Corporation (MBIA)

Terms and Concepts in School Debt Financing
CASBO Spring 2003 Pre-Conference
San Diego - April 22, 2003

**LEGAL AND DISCLOSURE DOCUMENTS
UTILIZED IN THE DEBT ISSUANCE
PROCESS**

Presented by John M. Hartenstein

Partner, Orrick, Herrington & Sutcliffe LLP

Basic Advice

- Review commitments and obligations.
- Demand explanations.
 - Representations and Covenants
 - Ongoing Responsibilities
 - Risks and Liability
- Rely on attorneys, consultants for advice.
- Don't relinquish decision-making to professionals.

Basic Financing Documentation

- Election, if needed
- Authorization
- Repayment or Security
- Offering
- Sale
- Closing
- Opinions
 - “It’s all about the bond opinion”

Election Documentation

Needed for any tax supported debt

- school bonds
- Mello-Roos bonds
- Resolution calling election
 - proposition summary
 - bond project list
 - direction to elections officer
 - any other covenants, limitations
- Tax Rate Statement
- Impartial Analysis
- Ballot Arguments and Campaign Flyers, etc.

Authorizing Resolution

- recitals: factual background; purposes
- financing parameters
- approve forms of major legal documents
- approve offering and sale documents, procedures
- further authorization, ratification

Security Agreement

- Indenture, Trust Agreement, Paying Agent Agreement, Fiscal Agent Agreement, or Resolution
 - Definitions
 - Security; Terms of repayment
 - Terms of early redemption
 - Tax covenants
 - Continuing disclosure
 - Trustee arrangements
 - Amendments
 - Default; remedies
 - Other covenants

Security agreement, contd.

- Lease, and Ground Lease in Lease Financing
- Other Documents
 - UCC financing statements
 - assignment agreement
 - title policies
 - bond insurance
 - etc.

Offering/Disclosure documents

- Purposes:
 - 1) SEC Compliance
 - 2) Protection against liability
- Preliminary Official Statement
- Official Statement
- 15c2-12 or “deemed final” certificate
- Rule 10(b)5 statements

Sale Documents (contract)

- Public Sale
 - Official Notice of Sale
 - Published Notice
 - Certificate of Award
- Negotiated Sale
 - Bond purchase agreement

Closing Documents

- Evidence of the transaction
 - receipts
 - signing authority
 - “bringdowns”
- Tax Documents
 - Tax Certificate or Non-Arbitrage and Rebate Certificates
 - representations and expectations
 - covenants
 - IRS Form 8038-G
- Continuing Disclosure Agreement or Certificate

BOND OPINION



Conclusion

- The documents are our friends.
 - Make sure they work for your financing.
 - Review and make needed changes
- Be a wise consumer of legal services.
 - Take an active hand in your financing.
 - Don't be afraid to demand satisfactory explanations.

CFD Administration

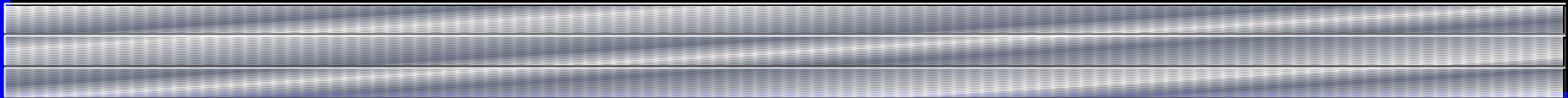
Basic Steps

- Know your CFD
- Be active prior to issuance
- Manage the funds
- Meet administrative obligation
- Customer service



Preparing Special Tax Levy

- Know your tax formula
- Update “development status”
- Allocate parcels to tax categories
- Determine special tax requirement
- Submit to Auditor’s office



Delinquency Management

- Accelerated judicial foreclosure
- The delinquency process
 - Strip special tax levy off roll
 - Notice to delinquent owners
- Foreclosure Counsel
- Thresholds



Continuing Disclosure

- SEC Rule 15c2-12
- Obligated Persons - Issuer & Developer
- What to disclose
 - Material events
 - Items in Continuing Disclosure Certificate
- Disclosure Counsel relationship
- Information Repositories - NRMSIRs
- Reports must be filed on time!



Annual Special Tax Report

- Summary of development
- Summary of account balances
- Status of improvements
- Summary of financial obligations
- List of parcels and levy
- CDIAC requirements



Public Information, Inquiries, Concerns

- Annual Reports/Continuing Disclosure
- Tax bill questions
- Professional requests



Other Administrative Items

- Arbitrage rebate calculation
- Reconcile bank statements
- Coordination with fiscal agent/trustee
- Prepayment calculations
- Record release of special tax lien
- Reimbursement for facility construction



Senate Bill 165

- Special Tax and Bond Accountability Act
- Most items were already requirements in the Mello-Roos Act
- Added reporting requirements
 - State amount of funds collected and expended and status of improvement projects
 - Filed with governing body by Jan. 1, 2002 and at least once a year thereafter
 - CFD report may serve purpose if information is sufficient



Consultants or Staff

- Staff's experience
- Evaluation of workloads
- Number of districts
- Complexity of districts
- Combined approach



**California Debt & Investment Advisory Commission &
California Association of School Business Officials
Annual Conference**

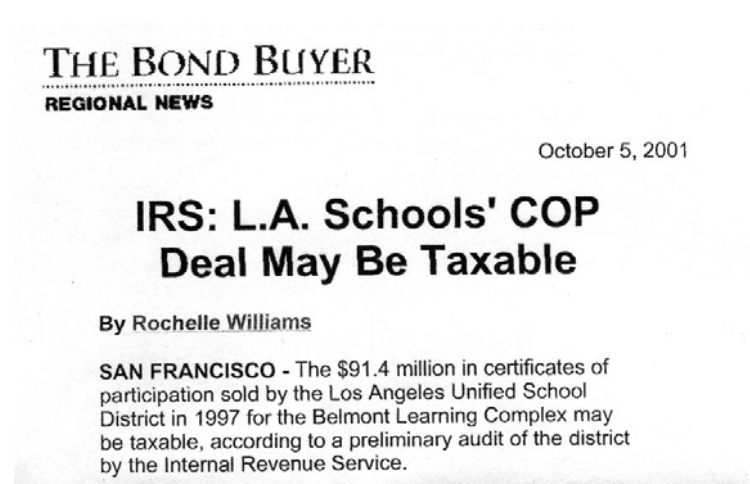
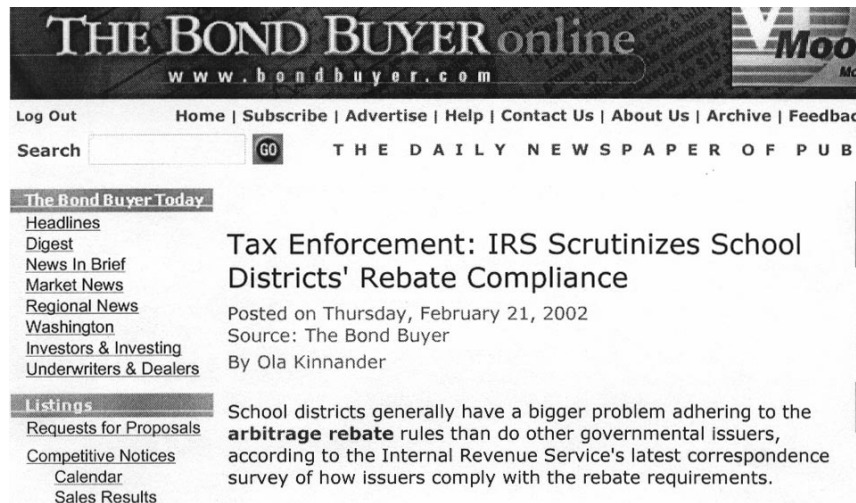
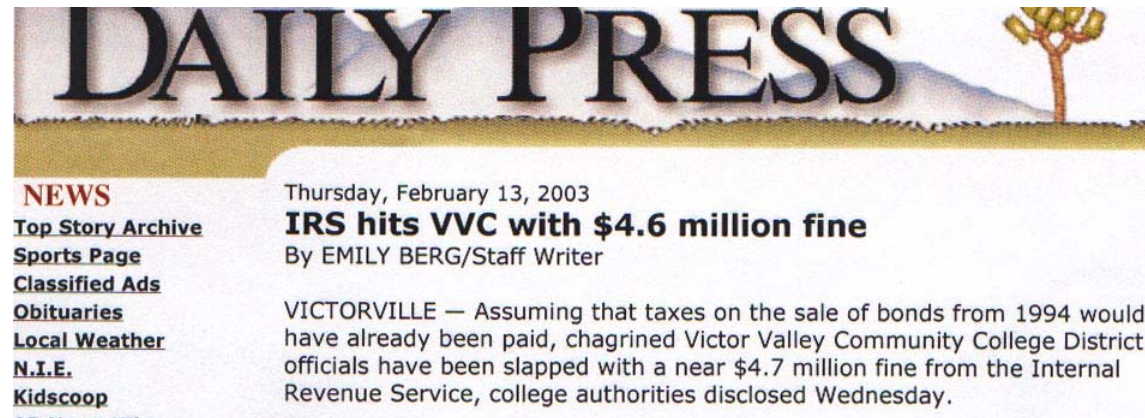
Investing Bond Proceeds In California



April 22, 2003

Bad Things Can Happen to Good People....

Some recent articles on school district bonds.....



Administration of Bond Proceeds

Proceeds held by County Treasurer

- ▼ Required to be deposited with County Treasurer or otherwise administered by Treasurer
- ▼ Includes: general obligation bonds, operating funds
- ▼ However, county treasurers take different approaches to bond proceeds:
 - ◆ Some allow individualized portfolios in certain circumstances.
 - ◆ Some do not want bond proceeds

Proceeds held by Outside Trustee

- ▼ Held by an outside trustee, who may receive investment direction from the school district, County Treasurer's Office or an outside firm
- ▼ May include: Mello-Roos CFD's, Certificates of Participation
- ▼ Governing document is the Board's resolution or Indenture.
- ▼ Districts may be on their own in terms of investing proceeds.

Bond Proceeds Funds

- ▼ Construction/Acquisition Fund
- ▼ Debt Service Reserve Fund
 - ◆ Not necessary if a GO Bond
- ▼ Capitalized Interest Fund
 - ◆ Required for COP's or lease-revenue bonds
- ▼ Lease Payment or Interest Fund
 - ◆ Maintained by trustee/paying agent for payment of principal and interest to bondholders
- ▼ Cost of Issuance Fund

Summary of Investment Objectives

▼ Safety

▼ Liquidity

▼ Compliance with legal restrictions

- ◆ Federal Tax Code
- ◆ Arbitrage rebate Restrictions
- ◆ State Law
- ◆ Local Ordinances
- ◆ Bond Covenants/Bond Insurer Requirements

▼ Return

▼ Stability

▼ Simplicity

Description of Basic Investment Process

- ▼ Identify purpose of investment
- ▼ Identify cash flow needs (i.e., a draw-down schedule)
 - ◆ A draw-down schedule is an estimate, will always be wrong
 - ◆ Build in some buffer
- ▼ Identify your risk tolerances
- ▼ Target securities that match your cash flow requirement and risk tolerances
 - ◆ Maximize yield subject to arbitrage limitations
 - ◆ Strike a balance between your different objectives
- ▼ Horizon and sensitivity analysis (what-if scenarios) and re-balancing, if necessary

Investment Choices

- ▼ Money-Market Fund
- ▼ County Pool
- ▼ Individually Structured/Managed Portfolio
- ▼ Guaranteed Investment Contract (GIC)

Pros and Cons of Different Investment Types

Money-Market Funds

A mutual fund with a weighted average maturity of less than 90 days invested in short-term securities such as Treasuries, US Agency discount notes and short-term corporate securities. Should only consider rated funds.

Advantages

- ▼ Simplicity
- ▼ Daily Liquidity
- ▼ Rated funds are available

Disadvantages

- ▼ Variable return
- ▼ On the short-end of the yield curve
- ▼ Exposes you to interest rate fluctuations

Pros and Cons of Different Investment Types

County Pool

Pooled investments held by the County Treasurer and invested solely by the County Treasurer. Investments are restricted by the Government Code.

Advantages

- ▼ Simplicity
- ▼ Daily Liquidity
- ▼ Higher yield than money-market funds
- ▼ May be rated

Disadvantages

- ▼ Variable return
- ▼ Exposes you to interest rate fluctuations

Pros and Cons of Different Investment Types

Individualized Portfolios

A customized portfolio consisting of short, highly liquid securities and intermediate securities structured to match a draw-down schedule. These may be managed directly by a firm or the agency itself.

Advantages

- ▼ Liquidity if properly structured
- ▼ Locks in rates
- ▼ Depending on forward rates, can maximize yield
- ▼ Allows issuer to diversify and minimize credit risk

Disadvantages

- ▼ Much more complex to administer
- ▼ Possible market losses
- ▼ Reinvestment Risk if drawn-down schedule is not accurate
- ▼ Fees

Pros and Cons of Different Investment Types

Guaranteed Investment Contracts (GIC's)

A contract with a financial institution that provides a fixed rate of return. Agreements may or may not have withdrawal provisions, termination clauses and collateralization requirements.

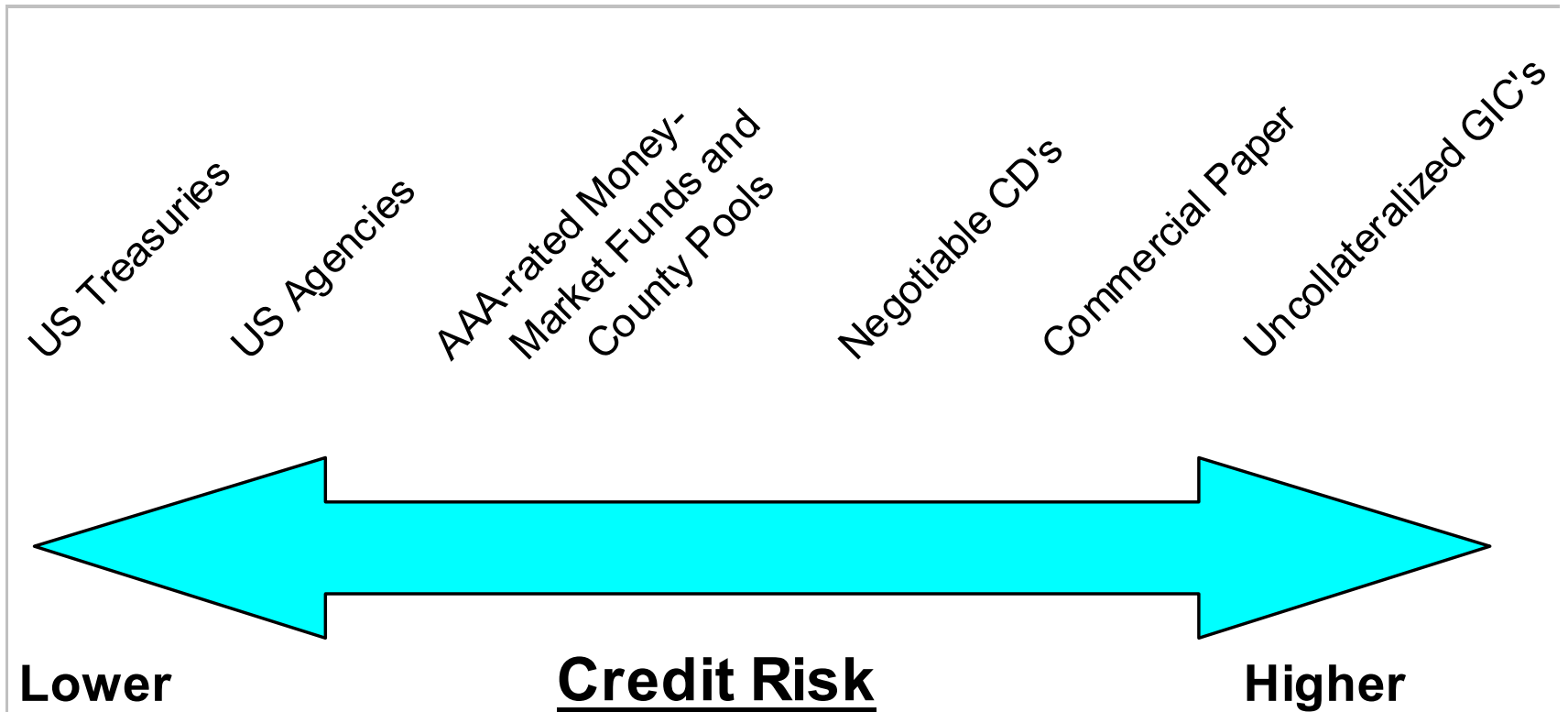
Advantages

- ▼ Simplicity
- ▼ Flexible withdrawal provisions
- ▼ No reinvestment risk -- locks in rates through maturity of contract
- ▼ Not marked to market

Disadvantages

- ▼ Illiquid
- ▼ Lack of diversification (money is held with one counterparty)
- ▼ No ability to take advantage of market opportunities
- ▼ Credit risk

Investment Risk by Security



Indicative Yields by Type of Security

As of April 1, 2003

▼ Money-Market Fund	
AAA-rated Prime Fund (institutional shares)	1.21%
AAA-rated Gov't. Fund (retail shares)	0.91%
▼ County Pool	2.60%
(AAA-rated San Bernardino County Pool)	
▼ Individualized Portfolio	< 2.00%
(AAA-rated securities < 3 yrs maturity)	
▼ GIC	
AAA-rated, collateralized, 2-yr. maturity	1.50%
AAA-rated, uncollateralized, 3-yr. maturity	2.00%

Do's and Don'ts

▼ Remember the principals of S - L -Y

▼ It is OK to use outside experts

- ◆ The law is complex in this area, so don't feel reluctant to use outside experts
- ◆ Make sure you receive independent advice (or at a minimum full disclosure of interests)
- ◆ Cost of these consultants is cheap and can be included in Costs of Issuance of bonds (no out-of-pocket cost to you)
- ◆ Consult with your County Treasurer

▼ Know what you are paying in fees. Remember that you are managing taxpayer's money.

▼ In the investing world, nothing is free. If you get a higher yield, there is a reason.

Do's and Don'ts (Continued)

- ▼ Don't be Afraid to Ask Questions, such as:
 - ◆ What are my alternatives?
 - ◆ If you don't understand a term, ask about it
- ▼ Regularly review your investments, since market conditions change frequently.
- ▼ Remember that you are the decision maker. Don't be intimidated into taking action if you are uncomfortable. *The client is always right.*
- ▼ Remember that any dollar you earn in investment income (below the arbitrage limit) reduces your debt service costs by that same dollar

Investment Checklist

- ☐ Compliance of investments with State law and Board resolution (or bond indenture)
- ☐ GIC's
 - ☐ Did you and bond counsel review legal documents?
 - ☐ Compliance with IRS guidelines regarding competitive bids and GIC broker fees (see safe harbor guidelines)
- ☐ Individualized portfolios
 - ☐ Were there competitive bids for securities?
 - ☐ Is your investment advisor independent from bidders?
- ☐ Money-Market Funds
 - ☐ Institutional shares versus retail shares
 - ☐ “Hidden” fees or loads
- ☐ Did you hire an arbitrage rebate firm?